United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

77-7138

To be argued by
MARVIN F. HARTUNG

United States Court of Appeals
FOR THE SECOND CIRCUIT

B

FRUEHAUF CORPORATION,

Plaintiff-Appellant,

against

SEATRAIN LINES, INC., and
STRICK CORPORATION,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES COURT OF APPEALS
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REPLY BRIEF OF FRUEHAUF CORPORATION, PLAINTIFF-APPELLANT

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Federal Rules of Civil Procedure Rule 52(a) 1, 2, 3

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REPLY BRIEF OF FRUEHAUF CORPORATION, PLAINTIFF-APPELLANT

Preliminary Statement

The brief of defendants-appellees is, understandably, based on the thesis that the essential findings of the court below are not clearly erroneous, that substantial evidence exists in support thereof and that, therefore, the judgment should be affirmed. In advancing this thesis heavy reliance is placed on that clause in Rule 52(a) of the Federal Rules of Civil Procedure which provides that "due regard shall be given to the opportunity of the trial courts to judge of the credibility of the witnesses."

The fact is that under the particular circumstances of this case the credibility of witnesses is not a decisive factor. The decisive factors are the legal import of the documentary evidence which lies at the heart of the dispute and to some degree certain evidence which the court below apparently overlooked. Subject to certain mischaracterizations of counsel, hereinafter pointed out, there is only one instance of conflicting evidence. In all other material respects the evidence is undisputed. It is the position of plaintiff-appellant ("Fruehauf") that in such a situation the "clearly erroneous" rule should be much less stringently applied, if at all, and that, in any event, there is more than ample evidence to support "a definite and firm conviction" on the part of this court "that a mistake has been made."

The "clearly erroneous" test set up in Rule 52(a), "by interpretation, is subject to exception and modification." *MacMullen* v. *South Carolina Electric and Gas Co.*, 312 F.2d 662 (4th Cir. 1963).

With respect to documentary evidence it was held in *Shumaker* v. *Groboski Industries, Inc.*, 352 F.2d 837 (7th Cir. 1965), as follows:

> "The District Court's findings of fact . . . are based on documentary evidence. We are in as good a position to consider this evidence as the District Judge, and his findings do not attain to that degree of finality under the Federal Rules of Civil Procedure, Rule 52(a), as findings which resolve issues of credibility in conflicting testimony. Welsh Co. v. Chernivsky, 7 Cir., 1965, 342 F.2d 586, 588; Taylor-Reed Corp. v. Mennen Food Products, 7 Cir., 1963, 324 F.2d 108, 111; Henriksen v. Cory Corp., 7 Cir., 1964, 327 F.2d 409, 412."

In *University Hills, Inc.* v. *Patton*, 427 F.2d 1094 (6th Cir. 1970), the reviewing court enlarged upon the above-

stated principle in the following language:

> "Although findings of fact adopted by a District Court are binding on an appellate court unless clearly erroneous, Fed.R.Civ.P. 52(a), the interpretation of written contracts, conclusions of law, mixed questions of fact and law, and findings as to an ultimate fact, adopted by the court, are not subject to the rule and are within the competence of an appellate court. Cordovan Associates, Inc. v. Dayton Rubber Co., 290 F.2d 858, 859-860 (6th Cir. 1961); *cf.* Union Planters Nat'l Bank v. United States, 115 F.2d 426 (6th Cir. 1970)."

The United States Supreme Court has held that "a finding is 'clearly erroneous' when, although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States* v. *U.S. Gypsum Co.*, 333 U.S. 364, 395 (1948).

Finally, we would note that this Circuit formulated the following guidelines in *Orvis* v. *Higgins*, 180 F.2d 537, 539 (2nd Cir. 1950), cert. denied 340 U.S. 810:

> "Where a trial judge sits without a jury, the rule varies with the character of the evidence: (a) If he decides a fact issue on written evidence alone, we are as able as he to determine credibility, and so we may disregard his finding. (b) Where the evidence is partly oral and the balance is written or deals with undisputed facts, then we may ignore the trial judge's finding and substitute our own, (1) if the written evidence or some undisputed fact renders the credibility of the oral testimony extremely doubtful, or (2) if the trial judge's finding must rest exclusively on the written evidence or the undisputed facts, so that his evaluation of credibility has no significance. (c) But where the evidence supporting his finding as to any fact issue is entirely oral testimony, we may disturb that finding only in the most unusual circumstances."

See also *Reyher* v. *Children's Television Workshop*, 533 F.2d 87 (2nd Cir. 1976).

I

Ownership of the Residual Equipment Prior to January 11, 1966

The documentary evidence which determines this issue consists of the Equipment Lease (Plaintiff's Exhibit 1) and the Purchase Agreement, Assignment and Schedule (Plaintiff's Exhibit 9). Other undisputed evidence is that in order to obtain additional funds from its finance subsidiary Fruehauf converted the Seatrain lease to a sale for accounting purposes, that thereupon it made an assignment to the Finance Company and that Strick was compensated by an intercompany credit based upon the discounted value of the remaining lease payments.

The court below resolved the issue of prior ownership against Fruehauf on the basis of the following (Appendix, p. 265):

(i) that Strick received no specific consideration for the residuals; and

(ii) that but for Fruehauf's subsequent divestiture of the Strick Division, the equipment would have been returned to Strick Division at the end of the lease.

From this the court concluded

> "Thus the net effect of these paper transacions was a sale of the right to Seatrain's lease payments to the Finance Company . . . The court finds that the Finance Company did not acquire any possessory interest in the underlying equipment and that the right to the residuals remained with Strick Division of the Fruehauf Corporation."

What the court below apparently overlooked in this connection was

(i) the equipment lease provision quoted on page 7 of our main brief to the effect that an assignee

thereof shall acquire all rights and remedies of the lessor, which included possessory rights;

(ii) the language of the Assignment quoted on page 8 of our main brief, indicating that not only were the lease payment balances assigned but the entire lease contract;

(iii) the necessary implication that property and possessory rights belong to the entity furnishing the financing (the Finance Company) and that such rights could be acquired without acquiring technical legal title, particularly in a transaction between parent and subsidiary (main brief, pages 8-9);

(iv) the testimony of Mr. Silverstein referred to on page 6 of our main brief that "it is my understanding that the Finance Company purchased that lease as a contract *and everything that went with it.*" (emphasis supplied); and

(v) that in reflecting the assignment to the Finance Company, Strick Division removed the Seatrain lease from its leased equipment account and recorded the transaction as a sale. Fruehauf witness Silverstein, Appendix, p. 85; Strick witness Bachman, Appendix, p. 194.

The brief of defendants-appellees (pages 4 to 8) repeats the narrow grounds relied on by the court and adds several other points. Some of these points involve flat misstatements as to the testimony of Fruehauf's witnesses. None of the points cited resolves the issue in Strick's favor. In the discussion below we will follow the order in which the various points are referred to in the brief of defendants-appellees.

With respect to the contention that Fruehauf's witness Silverstein "conceded that he was unaware of the existence of any document transferring title," reference is made to

subparagraphs (iii) and (iv) above. On the matter of compensation for the residuals, we have pointed out (main brief, page 5) that specific consideration for the residuals would not be decisive and that contracting parties may buy and sell property for any price agreed upon. See also subparagraph (v) above as to Strick's formal recording of the transaction as a sale.

The argument under paragraph (c) on page 5 of the brief of defendants-appellees is confusing and self-contradictory in that it seems to proceed on the theory that the language of the above-mentioned Assignment was completely inapplicable to the Seatrain lease, with the implication that nothing at all was transferred under the above-mentioned Assignment. The statement on page 5 of the brief of defendants-appellees that Mr. Silverstein "conceded that the residual equipment under the Seatrain lease was not included in any of the defined categories of assets transferred by the Assignment" is a complete distortion of his testimony. The same characterization applies to the statement at the bottom of page 7 and top of page 8 that "the undisputed testimony of Fruehauf's own witnessess admits that no such transfer was effected." Examination of the testimony at the referenced pages indicates that what the witnesses said was that the Seatrain lease as an instrument did not technically fit the definition of "customer obligation" in the Purchase Agreement, which contemplated a sale transaction. There can be no question, however, that the Seatrain lease was assigned, as demonstrated by its presence on the schedule of contracts annexed to the Assignment. In addition, Mr. Silverstein expressly testified that the Seatrain lease was treated as a sale both for accounting purposes and for the purpose of Plaintiff's Exhibit 9 (Silverstein, Appendix, pp. 138-140).

As to the point that but for the subsequent divestiture of the Strick Division the Seatrain equipment would have

been returned to Strick Division at the end of the lease, this obviously proves nothing, since this litigation would be non-existent in the absence of such divestiture and Strick Division would have remained the appropriate department of Fruehauf to handle the returned equipment.

With respect to the point made under paragraph (e) on page 6 of the brief of defendants-appellees concerning registration of the equipment in the State of Maine, we suggest that the most appropriate comment is that given by Judge Lumbard himself (Appendix, p. 202) that this "does not necessarily prove ownership, it just proves that they paid the money."

II

Effect of the FTC Order

The issue as to the effect of the FTC order is wholly documentary. Oral testimony on this subject is confined solely to background material. The opinion of the court below does no more than quote the phrases relied upon. Nor does the brief of defendants-appellees do anything further, except to refer derisively to certain language in our main brief. It contains nothing addressed to the analysis and argument set forth in our brief, which we will not repeat here. We would only add that the FTC order did not mandate a transfer of the Seatrain residuals because (i) at the time of the order Fruehauf had no property or possessory rights to transfer (see discussion under I above), and (ii) the value of such residuals (a maximum of approximately 1% of the purchase price, assuming they continued in existence through the remaining six years of the lease) was an immaterial part of the entire transaction and could not possibly have had any effect whatever in restoring Strick "as a going concern and effective competitor."

III

The Effect of the 1966 Agreement

The basic evidence governing the issue as to whether the Seatrain residuals were transferred to Strick in the divestiture sale is the 1966 Agreement, which provides for such sale. The specific question presented is as to the legal sufficiency for that purpose of certain provisions of that Agreement.

The undisputed evidence is that the 1966 Agreement was intended by both parties to comply with the FTC order; also that in the negotiation of the Agreement the Seatrain lease was not discussed.

Based upon the analysis in our main brief (pages 13 to 20), we do not believe there is any ambiguity in the Agreement requiring oral testimony as to the intent of the parties. The court below, however, chose to take oral testimony on such intent, at the conclusion of which it credited the testimony of an officer of Strick over testimony offered by Fruehauf. A review of this election as to credibility—the only such instance in the case—reveals that the court's evaluation appears to be based (i) on the fact that the testimony credited was consistent with the court's view of certain documentary evidence (the FTC order) and (ii) failure by the court to take cognizance of certain key passages in the testimony of Fruehauf's witness and the Court's consequent conclusion that the testimony of this witness was ambiguous. The details of the foregoing are set forth below.

The court summarizes the testimony of Freuhauf's witness Silverstein on this point as follows (Appendix, p. 268):

> "To Silverstein's knowledge the Seatrain lease was never specifically discussed and the 'residuals' (the equipment to be returned at the expiration of the

> lease) were not covered in the January 11 agreement. According to Silverstein, some equipment leases were sold to Strick and others were retained by Fruehauf; however, Silverstein failed to specify which leases were sold or what, if any, distinction was drawn between those leases sold and those retained."

Referring to another Fruehauf witness, the court's opinion continues as follows:

> "Rushmer also stated that the Seatrain lease was not specifically discussed during the negotiations and that it was his belief that the residuals were not transferred to Strick under the January 11 agreement. In reference to section 2(a) of the contract, Rushmer stated that in his opinion the language 'and all movable equipment wherever located' covered only equipment used in a plant."

Testimony of Strick's witness Bachman on this point is summarized thus (Appendix, p. 269):

> "Although the Seatrain lease was not specifically discussed, he stated that at the time the agreement was entered into it was Strick's understanding that all equipment under lease was included in the sale. In fact, according to Bachman, the language 'and all movable equipment wherever located used in the operations of Strick Division, whether or not expensed . . . or for other reasons not given a carrying value . . .' was purposely inserted to include equipment which, like the Seatrain residuals, would not appear on the balance sheet because it had no book value; further, he indicated that this language was intended as a catchall to ensure compliance with the FTC order that all Strick Division assets be divested."

Immediately following, the court makes his election between these divergent versions of the intent of the parties.

The court's language is as follows (Appendix, p. 269):

> "The court credits Bachman's testimony; *it is consistent with the predominant purpose of the sales agreement, which was to comply fully with the order of the FTC.*" (Emphasis supplied)

Later in his opinion, the court reinforces the emphasized clause quoted above with the following (Appendix, p. 270):

> "It is hard to imagine that the parties could have meant to leave Fruehauf any assets or any right to reclaim assets which had been owned or controlled by Strick Division."

It is evident that in opting for the Bachman version, the court below relied heavily on his view of the FTC order (a view formed without the aid of any oral testimony). But, as we have demonstrated, the FTC order did not determine that Strick was entitled to the Seatrain residuals. See Point II of our main brief; also page 7 above.

The second basis of the court's opting in favor of Bachman is undoubtedly his impression that Silverstein failed to substantiate his testimony that some leases were sold and some were not, it being the court's impression that Silverstein did not specify *which* were sold and *which* were retained and the basis of differentiation. In this impression the court was plainly in error. Mr. Silverstein's testimony (quoted verbatim pages 19 and 20 of our main brief) was that full payout leases such as the Seatrain lease were *not* sold but that non-full payout leases were sold.

The brief of defendants-appellees attempts to enlarge upon the court's rationale with respect to the effect of the 1966 Agreement. At the top of page 13, Appendix references (pages 195-97) are made to further testimony of Mr. Bachman. An examination of such references reveals that in response to questions on direct examination the witness said the Seatrain lease was covered in "property, plant

and equipment and specifically [in] the breakout for equipment leased to others." The fact is, however, as stated in our main brief (page 20), there is no breakout of "Equipment leased to others" either in the 1966 Agreement or in the Comparative Balance Sheet annexed thereto. This caption appears for the first time in the Approved Balance Sheet (Defendants' Exhibit E, Exhibit Volume, p. 362) bearing certificate of Touche, Ross, Bailey & Smart dated March 22, 1966. Obviously, the March 22 document was not before the parties on January 11, the date of the 1966 Agreement, and Mr. Bachman is in error. Nor is "Equipment leased to others" a breakout under "Property, Plant and Equipment." It is a subcaption under an item entitled "Other Assets," a completely separate, independent item. Finally, the amount shown on the March 22 document obviously does not include the Seatrain lease. It covers non-full payout lease equipment having a balance sheet value; there is no footnote indicating it also covers equipment under full payout leases having no balance sheet value. See page 20 of our main brief.

Finally, on page 14 of their brief defendants-appellees, referring to our main brief, make the statement that "Fruehauf readily concedes that the equipment at issue here was used in the operations of the Strick Division." This is a gross mischaracterization of what was said, as clearly evidenced by the quoted passage from our brief that immediately follows this statement. What was "conceded" was, in the court's phrase, that "the operations of the Strick Division included the leasing of its products." We then went on to make a vital distinction, i.e., that the *activity* of leasing (which could be fairly embraced within the operations concept of Section 2(a)) was something quite different from the *product* leased. Trailers (products) are the *objects* of leasing operations, they do not *carry on* leasing operations. Stated another way, trailers are not productive instrumentalities in the conduct of the leasing business, they are simply the commodity dealt with in the conduct of such business.

IV

Conduct of the Parties

We believe that our main brief sets forth all of the significant considerations on this aspect of the case. We have only one further comment, after noting the treatment of this subject in the brief of defendants-appellees: the essential point is not the various actions by *Seatrain* that are referred to, and Seatrain's reasons therefor, but the responses to such actions, or lack thereof, by Strick. Thus, for example, in the case of the wrecked equipment in which Seatrain compensated Fruehauf rather than Strick, what is important is not why Seatrain made payment to Fruehauf but why Strick made no claim to such payment since it insists it owned the equipment.

This leads us to ask once more the question put at page 9 of our main brief (a question which defendants-appellees have made no attempt to answer): What would have happened if Seatrain had defaulted on the lease? Would *Strick* have repossessed the equipment and left the Finance Company out of pocket for the balance of the lease payments? Such a result is unthinkable. We repeat our belief that it is axiomatic that one does not separate the security (the equipment) from the risk bearer, i.e. the entity furnishing the financing, and that there was no such intent here.

CONCLUSION

The judgment in favor of the defendants-appellees should be reversed and the cause remanded to determine the damages of plaintiff-appellant.

Respectfully submitted,

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